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SUBJECT: KUWAIT THIRD/FOURTH QUARTER ECONOMIC SNAPSHOT

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¶1. (SBU) Despite the current angst about the stock market's fall (down over 40% YTD) and the very public bail out of Gulf Bank, Kuwait,s economy grew at just under six percent in 2008 and is projected to weaken only slightly next year. Kuwait's government revenues for the first 7 months of the fiscal year (through October 31), were almost 30 percent higher than projected for the entire fiscal year. Even with the sharp drop in oil revenues and projected increases in spending for the last half of the year, a 2008/2009 budget surplus is still likely. In the near-term it would appear that Kuwait is well positioned financially to weather the current crisis. In the long-term, economic reform will be the key to Kuwait,s economic stability.

Economic Outlook: 5.8% Growth expected in 2009

¶2. (SBU) Economic growth for 2008 is projected to remain strong (at just under 6%), despite Kuwait's recent stock market crisis and sharply falling oil prices. Annual inflation is predicted to be about 10% for the year, on the back of high food prices and housing shortages. Current forecasts are that the economy will grow by about 5.8% in 2008, at least partially on projected government infrastructure expenditures. Continued oil price drops could, however, lead to cuts in oil production (about 40% of real GDP), and sharp cuts in government revenue. These cuts, combined with the impact of the sharp fall in the equity markets and its possible impact on Kuwait's financial and real estate sectors could cause these projections to be revised downward.

Fiscal Surpluses Strong

¶3. (SBU) Even with the sharp drop in oil prices in recent weeks and with increased spending to deal with the current financial crisis, Kuwait's 2008/09 budget is comfortably in the black. In the first seven months of FY 2008/09, Kuwait earned revenues over USD 57 billion, which exceeded projected revenues for the entire year by 30 percent. (Note: In calculating budget revenues, Kuwait adopted a conservative price of 50 dollars per barrel for its oil, but the actual average price for the first half of the year was above 100 dollars per barrel. It recently dropped to less than 50 dollars per barrel. End note). Kuwait's expenditures in the first six months were $24.7 billion, less than a third of the 71 billion USD forecasted for the entire year, leaving a preliminary budget surplus of 32.7 billion USD. Budget revenues for the second half of the year will drop sharply and expenditures are likely to increase as the GoK funds

various financial sector bail outs; but fiscally 2008/09 will continue to be strong. The budget situation in 2009/10 will deteriorate with lower oil revenues and higher expenditures; but even if the budget slips into deficit, Kuwait's reserves will likely remain more than adequate to cover any shortfall.

Record Inflation

¶4. (SBU) Kuwait continued to struggle with high inflation for the first half of the year (10.7 percent, or almost double the 2007 figure). The driving factors were food and housing costs, which rose by 14.2 percent and 13.1 percent since April 2008. Early in FY 2008, the Central Bank imposed restrictions on real estate, share lending and consumer loans to try and rein in growth in the money supply, but has recently eased its policy in order to deal with the stock market collapse.

¶5. (SBU) The GoK took several steps to try and deal with sharply rising food costs. In August and September, Kuwait's Government approved a plan to subsidize more goods, support firms operating in livestock and flour mill sectors, allow cooperative supermarkets to import commodities directly, cut out wholesale importers, and create a consumer protection body to prevent fraud and exports of subsidized products. The GoK is looking at other means to cope with the crisis, such as wheat cultivation and leasing rice fields in Cambodia. The GoK did, however, take several inflationary steps including raising salaries for citizens twice during the second and third quarter.

¶6. (SBU) Comment: In the near term, falling oil prices and sharp drops in global equity markets are concerning Kuwaitis. Parliamentary and public calls for the GoK to bail out the stock market and investors are increasing, as are the GoK's public commitments to act. Given Kuwait's strong economic growth over the past few years and comfortable budget and current account surpluses, it has the reserves needed to address the current problems. In the longer run, however, absent a solution to the dysfunctional relationship between government and parliament, political paralysis will continue to hinder Kuwait's economic reform efforts. Several key legislative bills that would boost Kuwait's economy, have yet to be passed by Kuwait's parliament, to include a privatization law and delay of the fourth refinery project estimated at 10 billion dollars. To quote one Kuwaiti banker frustrated by the parliament's failure to address widely recognized issues, "Kuwait's problem is that we don't have any problems." End Comment.

JONES